



CITY OF PHILADELPHIA

LAW DEPARTMENT
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July 9, 2004

United States District Court for the
Eastern District of Pennsylvania
U.S. Courthouse
601 Market Street,
Philadelphia, PA 19106

**Re: Teamsters Health and Welfare Fund, Philadelphia and Vicinity, et
al. v. Net Construction, Inc. and City of Philadelphia
No. 02-4639**

To the Court:

Pursuant to Judge Bartle's direction, enclosed please find two copies of the City of Philadelphia's Memorandum of Law in Opposition to RLI Insurance Company's Motion to Obtain Stay of Execution Proceedings and Transfer of Contract Balances to Surety and a disk with the document in PDF format, for the above-captioned case. Also enclosed is a stamped envelope for your convenience in returning a time-stamped copy to my attention.

Should you have any questions, please contact me at the number listed above or contact my secretary Clare Wombough at (215) 683-5303.

Very truly yours,


Marissa M. O'Connell
Deputy City Solicitor

MMO:cw

Enclosure

**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

**TEAMSTERS HEALTH AND WELFARE
FUND, PHILADELPHIA AND VICINITY, et al.**

Plaintiff

vs.

NET CONSTRUCTION, INC.

Defendant

and

CITY OF PHILADELPHIA

Garnishee

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CIVIL ACTION

NO: 02-4639

ORDER

AND NOW, this day, of , 2004, upon consideration of the Motion of RLI Insurance Company to Intervene in and Stay Execution Proceedings and for an entry of an Order directing the City of Philadelphia to transfer the remaining contract balances to the Surety, it is hereby ORDERED AND DECREED as follows:

1. RLI Insurance Company's Motion for Stay of all Execution proceedings brought by the Teamsters Health and Welfare Fund of Philadelphia and Vicinity, et al. for a levy of any monies being held by the City of Philadelphia pertaining to work contracted by Net Construction Inc, for the City of Philadelphia is DENIED.

2. The City of Philadelphia is ORDERED to retain the remaining contract balances of \$17,291.35 and \$2,442.48 from its contract(s) with Net Construction Inc. to be applied to Net Construction Inc.'s outstanding tax obligations owed to the City of Philadelphia.

3. The Writ of Execution filed by the Teamsters Health and Welfare Fund of Philadelphia and Vicinity, et al. against the City of Philadelphia is discontinued.

BY THE COURT

J.

**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

**TEAMSTERS HEALTH AND WELFARE
FUND, PHILADELPHIA AND VICINITY, et al.**
Plaintiff

vs.

NET CONSTRUCTION, INC.
Defendant

and

CITY OF PHILADELPHIA
Garnishee

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:CIVIL ACTION

NO: 02-4639

**GARNISHEE'S MEMORANDUM OF LAW IN OPPOSITION
TO RLI INSURANCE COMPANY'S MOTION TO
OBTAIN STAY OF EXECUTION PROCEEDINGS
AND TRANSFER OF CONTRACT BALANCES TO SURETY**

Garnishee, City of Philadelphia ("City"), through its undersigned counsel, files this Memorandum of Law in Opposition to RLI Insurance Company's ("RLI") Motion to Obtain Stay of Execution Proceedings and Transfer of Contract Balance of Surety.¹

I. STATEMENT OF FACTS

The facts in this case do not appear to be disputed. The City of Philadelphia entered into various contracts with Net Construction, Inc. ("Net") for work. In both of the contracts involved in this particular case, the work was substantially completed and accepted, certain contract balances were placed on tax hold due to Net's outstanding tax obligations to the City. The City

¹ The City notes that RLI's Motion to Intervene was granted by this Court on June 21, 2004 and will thereby not respond to that portion of the Motion.

of Philadelphia's Department of Revenue audited and assessed Net for additional taxes in the amount of \$691,462.00 plus interest and penalties which continue to accrue.

The amounts on hold include \$17,291.35 on bid #2547 and \$2,442.48 on bid #2362. RLI is the surety on contract bid #2547 and National Surety Corporation ("National") is the surety with respect to contract bid #2362. The City advised both parties of the Writ of Execution filed by the Teamsters Health and Welfare Fund of Philadelphia and Vicinity, et al. ("Teamsters") and received no further communication from National.

Therefore, the dispute between RLI, the Teamsters, and the City is with respect to the funds held on contract bid #2547. The dispute as to the remaining funds is between the Teamsters and the City.

The parties do not dispute that Net Construction, Inc. is indebted to the City for outstanding tax obligations. See attached printout from the City of Philadelphia Department of Revenue's computer records stating Net's tax liabilities as of July 9, 2004 as Exhibit "A".

II. LEGAL ARGUMENT

The City's right to set off the retained contract balances is superior to the rights of RLI and the Teamsters.

As stated in the City's Answers to Interrogatories and New Matter, but not mentioned in RLI's Motion, under 53 P.S. §§ 16081, 16082 and 16083 ("Statute") the City may withhold payment of claim because such person owes taxes to the City. The City routinely withholds disbursement of funds to contractors, also referred to as vendors, when contractors fail to file and/or pay self-assessed taxes owed to the City. This right of set-off is superior to the contractor's right to receive payment of the funds.

Under state law the Teamsters through its Writ of Execution steps into the shoes of Net and has the same rights Net would otherwise have to the contract balances. See

Pennsylvania Rules of Civil Procedure, Rule 3111. If Net has no right to the contract balances due to Net's outstanding tax obligations, then the Teamster's have no right to the contract balances.

Case law also supports the City's right to the contract balances. The City does not dispute RLI's argument that Pearlman v. Reliance Insurance Company, 327 U.S. 132, 83 S.Ct. 232 (1962) and Jacobs v. Northeastern Corporation, 416 Pa. 417, 426-427, 206 A.2d 49, 54 (1965) hold that under the doctrine of equitable subrogation RLI has rights superior to the Teamsters to the contract balances. However, the City disagrees with the conclusion drawn by RLI that the surety's rights are superior to the City's based on these holdings. In both of those cases there was no right of set-off claimed, the dispute was only between the surety and a general creditors fund.

In United States v. Munsey Trust Co. of Washington, DC., 332 U.S. 234, 67 S.Ct. 1599 (1947), the Supreme Court of the United States specifically addressed the government's right to set off claims prior to payment to the contractor's surety who paid subcontractors for labor and materials on a project. In Munsey the surety argued that based on its payment to laborers and materialmen, that it had a right superior to the United States in the retained contract balances. The Court held that, "the government properly used its right to set off its independent claims." Munsey, at 244.

In Pearlman v. Reliance Insurance Company, 371 U.S. 132, 83 S.Ct. 232 (1962), the bankruptcy trustee argued that the Supreme Court's decision in Munsey Trust Co., supra, changed the surety's right to the contract balances. The Court stated:

The point of issue in that case was whether the United States while holding a fund like the one in this case could offset against the contractor a claim bearing no relationship to the contractor's claim there at issue. We

held that the government could exercise the well-established Common law right of debtors to offset claims of their own against their creditors. This was all we held.

Pearlman, at 257. The Court in Pearlman did not disrupt the specific holding in Munsey. Pearlman holds that having paid the contractor's claims, the surety steps into the contractor shoes and acquires a right of subrogation. However, the surety cannot have rights to funds which the contractor would not otherwise be entitled. Munsey at 242. The government was entitled to set-off the contract balances to satisfy its own claims prior to paying the contractor. Applying the rationale, RLI does not have rights superior to the City.

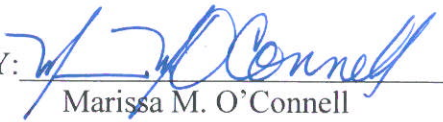
Taken together, if Pearlman did not disrupt the holding in Munsey then the City's right to retain the contract balances to set-off its debts is superior to the surety's right to the contract balances. If the surety's right is superior to the Teamster's rights, then the City's right to retain the funds is superior to both the Teamsters and RLI.

WHEREFORE, the City of Philadelphia respectfully requests that this Honorable Court deny RLI's Motion to transfer the remaining contract balances and hold that the City's right to retain the contract balances to be applied to Net's outstanding tax liabilities is superior to both the Teamsters and RLI rights in the contract balances.

Respectfully submitted,

PEDRO A. RAMOS
City Solicitor

Frank Paiva, Jr.
Divisional Deputy City Solicitor

BY: 
Marissa M. O'Connell
Deputy City Solicitor

Dated: July 9, 2004

LANA177
T015 _____TIPS ACCOUNTING SYSTEM
ACCOUNT LIABILITY07/09/04
10:59:36

ENTITY: EIN / 232750992____ NAME : NET CONSTRUCTION INC_____
 ACCOUNT : BPT ADDRESS: 1130 CHURCH RD_____
 ACCOUNT ID : 6555551 BUSINESS PRIVILEGE_____
 I&P CALC DATE: 07/09/2004 PERIOD START DATE: _____

PERIOD	PRINCIPAL	INTEREST	PENALTY	OTHER	TOTAL	STATUS
BPT	6555551					
12311995Y	NON-FILER					CASE
12311997Y		1305.15	2021.25		3326.40	RECON
12311999Y	135600.00	85428.00	127125.00		348153.00	CASE
12312000Y	140762.00	72709.11	112628.31		326099.42	CASE
12312001Y	129411.00	51140.56	83974.10		264525.66	CASE
04152002Y		17072.76	42681.90		59754.66	
12312002Y	30162.00	4524.30	10179.68		44865.98	CASE
04152003Y	30162.00	4524.30	10179.68		44865.98	CASE
TOTAL	466097.00	236704.18	388789.92		1091591.10	

PF1=HELP PF5=ACCT-DETAIL PF7=BACKWARD PF8=FORWARD
 CANNOT PAGE BACK FARTHER

MORE: Y
 PF12=MENU

Exhibit "A"

LANA177
T015TIPS ACCOUNTING SYSTEM
ACCOUNT LIABILITY07/09/04
10:59:39

ENTITY: EIN / 232750992 NAME : NET CONSTRUCTION INC
 ACCOUNT : WAG ADDRESS: 1130 CHURCH RD
 ACCOUNT ID : 6555551 WAGE
 I&P CALC DATE: 07/09/2004 PERIOD START DATE:

PERIOD	PRINCIPAL	INTEREST	PENALTY	OTHER	TOTAL	STATUS
WAG	6555551					
12311998M	16386.00	10650.90	15771.53		42808.43	CASE
12311999M	14981.00	7939.93	12172.06		35092.99	CASE
12312000M	5583.00	4320.92	8778.48		18682.40	CASE
12312001M	38285.00	11102.65	19621.06		69008.71	CASE
12312002M	38019.00	6463.23	13781.89		58264.12	CASE
12312003M	NON-FILER					BILL
TOTAL	113254.00	40477.63	70125.02		223856.65	
ENT TOTAL	579351.00	277181.81	458914.94		1315447.75	

PF1=HELP PF5=ACCT-DETAIL PF7=BACKWARD PF8=FORWARD
 NO MORE RECORDS FOR THIS VIEW

MORE:
 PF12=MENU

CERTIFICATE OF SERVICE

I hereby certify that service of a true and correct copy of the attached Garnishee's Memorandum of Law in Opposition to RLI Insurance Company's Motion to Obtain Stay of Execution Proceedings and Transfer of Contract Balances to Surety was made on the 9th day of July, 2004, to the following by mailing the same in a postage-paid envelope addressed as follows:

Susan A. Murray, Esquire
FREEDMAN AND LORRY, P.C.
400 Market Street, Suite 900
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Paul T. T. DeVlieger, Esquire
HARRY R. BLACKBURN & ASSOCIATES, P.C.
1528 Walnut Street
Philadelphia, PA 19102

Net Construction, Inc.
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